

**Presentation to:**



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**Debt Capacity: Setting the  
Right Standards**

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**2009 Fall Conference**

# U.S. NATIONAL DEBT CLOCK

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The national debt of the United States

# A Scare from Across the Pond

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“UK's top credit rating under threat...” – *Times Online*

“UK credit warning - who is next?” – *thisismoney.co.uk*

“Who's afraid of credit rating agencies?” – *theglobeandmail.com*

*Is the United States' 'AAA' Rating at Risk?*

# Signs That We Are Maxed Out

## Personal

- You stop getting 50 credit card solicitations in the mail every day.
- Your credit card company jacks up your rates.
- Your bank freezes your home equity line.
- You can't refinance your mortgage, buy a new car, or even get a cell phone.
- People with soothing voices from credit counseling firms start to call you out of the blue.

## County/City/Town

- The rating agencies say "Wow, we didn't expect to see you so soon"
- Your local bank won't take your calls.
- You get no bids for your bonds.
- Citizens in revolt over service cuts.
- Your Finance Director suddenly retires to become a shepherd in Ireland.

## Uncle Sam

- US Mint promoted to "Cabinet" status.
- The Chinese Premier stops taking your calls.

# Why Should We Care About This Topic?

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- Ability to Cost-Effectively Access the Capital Markets Has Broad Implications for:
  - Budget and Fiscal Flexibility
  - Ability to Provide Essential Governmental Services
  - Credit Rating
  - Availability of Liquidity Support

# Municipal Yields Since 1980

GO 20 Year Bond Index (1980-Present)

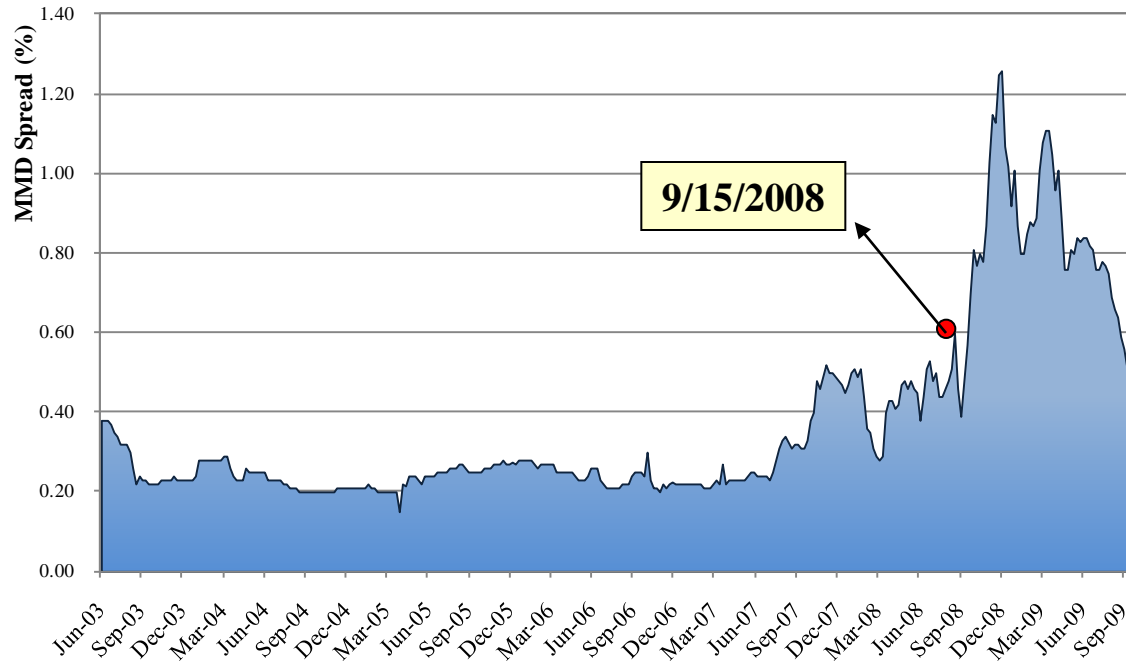


As of  
10/02/2009:  
3.94%

- **Average Since 1980:** 6.63%
- **Average Since 2004:** 4.57%
- **Average Since 2008:** 4.80%
- **Average Since 9/15/2008:** 4.91%

# “A” Rated to “AAA” Rated MMD

**A-AAA MMD Spread  
Since June 2003**



- **Average Spread June 2003- Sept. 2008: 0.28%**
- **Average Spread Sept. 2008 - Present: 0.83%**

# Debt Capacity and Debt Affordability

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- Debt Capacity and Debt Affordability are Closely Related.
- Debt Capacity Represents a Legal or Self-Imposed Policy Limit on Outstanding Indebtedness.
- Debt Affordability Encompasses the Concept of “Ability to Pay”. *Question: I am Authorized to Borrow the Money, But Do I Have the Cash Flow to Pay the Debt Service?*
- Prior to the Housing Collapse, Many Individuals Were Deemed to Have the Capacity to Buy Expensive Houses – We Now Find Out That Too Few Could Do So Affordably.

## Debt Capacity in the Eye of the “~~Be~~...Bondholder”

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- In one way or another, *the credit markets (ie; buyers of bonds) will tell us all when we have borrowed enough.*
- Laws present outside boundaries or “statutory debt limits” that tell the governmental borrower the size of the maximum legal credit line.
- In most cases, this limit is so far removed from reality that it would be irrational to assume that a government would tax its citizens sufficiently to service the debt.
- For this reason, the determination of TRUE debt capacity is largely a function of the judgments of parties external to the government.

# G.O. Debt Capacity – State and Local Law

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## Counties

- No Limit; Referendum Required

## Cities and Towns

- Up to 10% of Assessed Value of Real Property

## Authorities

- Typically controlled by trust indenture

✓ Note that local law/policy may impose stricter limits

# What Debt Are We Measuring?

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1. Direct Long-Term Debt and Debt-Like Obligations of the Borrower
  - G.O. Bonds
  - Appropriation-Backed/Certificates of Participation
  - Revenue Bonds Backed by General/Excise Taxes
  - Special Tax Districts
  - Non-Self Supporting Enterprise Obligations (see below)
  
- Overlapping/Underlying Debt
  - Cities and Towns within a County
  - Contingent Obligations (*ie; moral obligations*)
  
2. Exclude Enterprise-Related Debt for Which Fees and Charges are Levied for Services Where There are Private Sector Equivalents (*ie; utility services*) to the Extent That Self-Support Can Be Demonstrated.

# Measuring Debt Capacity – Rating Agency Criteria

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## Debt-to-Assessed Value

- Really “Estimated Market Value of Taxable Property”
- Reviewed on a Direct and Overlapping/Underlying Basis
- Includes Real Property, Personal Property, Other
- One of the Key Metrics for Measuring Debt Burden for Local Governments in the U.S.
- Benchmark:
  - <1.5% = Low
  - 1.5-2.5% = Moderate
  - 2.5-5.0% = Above Average
  - >5.0% = High

# Measuring Debt Capacity – Rating Agency Criteria

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## Debt-to-Personal Income

- Rating Agencies Do Not Use this Measure in Their Calculations for Local Governments.
- Reserved for States Primarily.
- However, if Employed as a Policy Ratio That is Tracked, Rating Agencies Will Monitor Compliance.
- Benchmark: None Recommended for Local Units

# Measuring Debt Affordability – Rating Agency Criteria

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## Debt Service-to-Expenditures

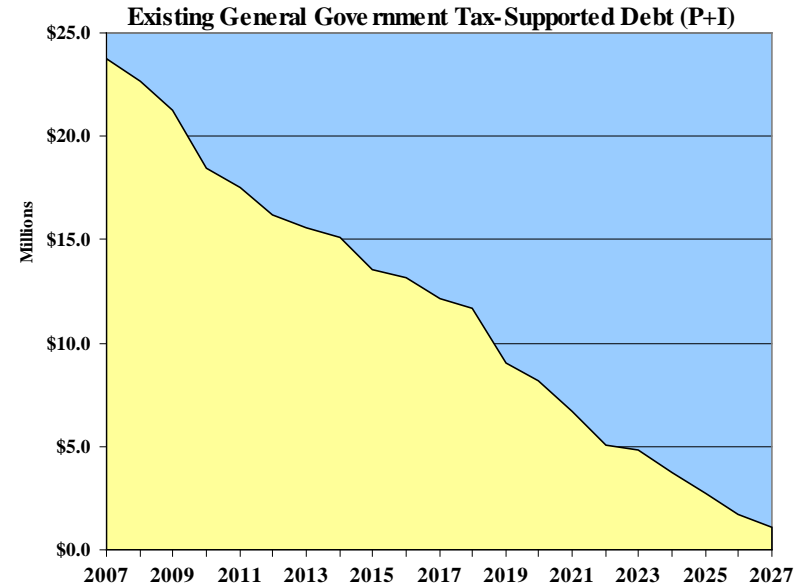
- Measures How Much of Annual Budget is Consumed by Fixed Debt Service Costs.
- Too High a Level Indicative of Over-Leverage and Budgetary Stress.
- Benchmark:  $\leq 10\%$  of Budget
- Ratio Can Be Above 10% if 10-Year Payout of Debt is High (eg;  $>60\%$ )

## **A Case Study**

# Existing General Government Debt Service

Fiscal Year	Principal	Interest	Total	Payout Ratio
2007	\$17,164,164	\$6,579,623	\$23,743,787	9.38%
2008	15,672,699	6,981,374	22,654,072	17.94%
2009	14,851,808	6,428,306	21,280,114	26.05%
2010	12,527,980	5,925,667	18,453,647	32.90%
2011	12,097,213	5,431,720	17,528,933	39.51%
2012	11,267,606	4,904,932	16,172,538	45.66%
2013	11,146,136	4,400,898	15,547,034	51.75%
2014	11,221,717	3,906,429	15,128,146	57.88%
2015	10,152,952	3,397,710	13,550,662	63.43%
<b>2016</b>	<b>10,249,433</b>	<b>2,911,861</b>	<b>13,161,294</b>	<b>69.03%</b>
2017	9,715,428	2,450,787	12,166,214	74.34%
2018	9,697,475	2,002,946	11,700,421	79.63%
2019	7,427,488	1,610,118	9,037,606	83.69%
2020	6,882,502	1,272,024	8,154,525	87.45%
2021	5,700,000	983,939	6,683,939	90.57%
2022	4,360,000	727,024	5,087,024	92.95%
2023	4,360,000	467,705	4,827,705	95.33%
2024	3,425,000	347,485	3,772,485	97.20%
2025	2,525,000	208,830	2,733,830	98.58%
2026	1,595,000	110,338	1,705,338	99.45%
2027	1,005,000	47,738	1,052,738	100.00%
<b>Total</b>	<b>\$183,044,599</b>	<b>\$61,097,454</b>	<b>\$244,142,053</b>	

Note: Assumes 2006 BAN Redeemed with 20 year level principal bond issue in June 2007 at a rate of 4.75%. Allocates \$847,251 of capital lease interest to principal since amortization not available.



- 1. City Enjoys Solid Payout Ratio.**
- 2. A Ten Year Payout Ratio In Excess of 65% Is Considered Rapid by Wall Street Standards.**
- 3. Consider Adding New Debt in a Manner that Maintains this Strength.**

## **Five Year Pro-Forma Debt Capacity**

# Measuring Debt Capacity – Fiscal Years 2007-2011

- The Following Tables Demonstrate the City’s Projected Capacity to Issue New Debt from Fiscal Years 2007 to 2011 while Maintaining Compliance with the City’s Existing Debt Policy Guidelines.

**Outstanding Debt vs. Real Estate Assessed Value Only <sup>(1)</sup>  
Debt Capacity at Existing 5.00% Policy Level**

Fiscal Year	2007	2008	2009	2010	2011	Total 5 Year Capacity
<i>Annual Capacity (millions \$)</i>	\$233.03	\$21.62	\$20.13	\$17.35	\$16.35	<b>\$308.49</b>

*(1) Future annual growth of real estate assessed value conservatively projected at 5.0%.*

**Debt Service vs. Expenditures  
Debt Capacity at Existing 10.0% Policy Level - Level Principal<sup>(1)</sup>**

Fiscal Year	2007	2008	2009	2010	2011	Total 5 Year Capacity
<i>Annual Capacity (millions \$)</i>	\$0.00	\$13.80	\$35.00	\$50.00	\$27.00	<b>\$125.80</b>

*(1) Assumes 7.0% annual growth in expenditures, and projected debt structured with 20 year level principal repayment at estimated 5.0% interest rate.*

# Key CIP Assumptions - Fiscal Years 2007-2011

- All Proposed New Project Debt Structured with 20 year Level Principal Repayment at Estimated 5% Interest Rate (Except Winter/Spring 2007 Bond Issue at 4.75% Interest Rate).
- Cash Funding from School Capital Reserve Shifted to Borrowing Until Fund Balance Target Achieved.

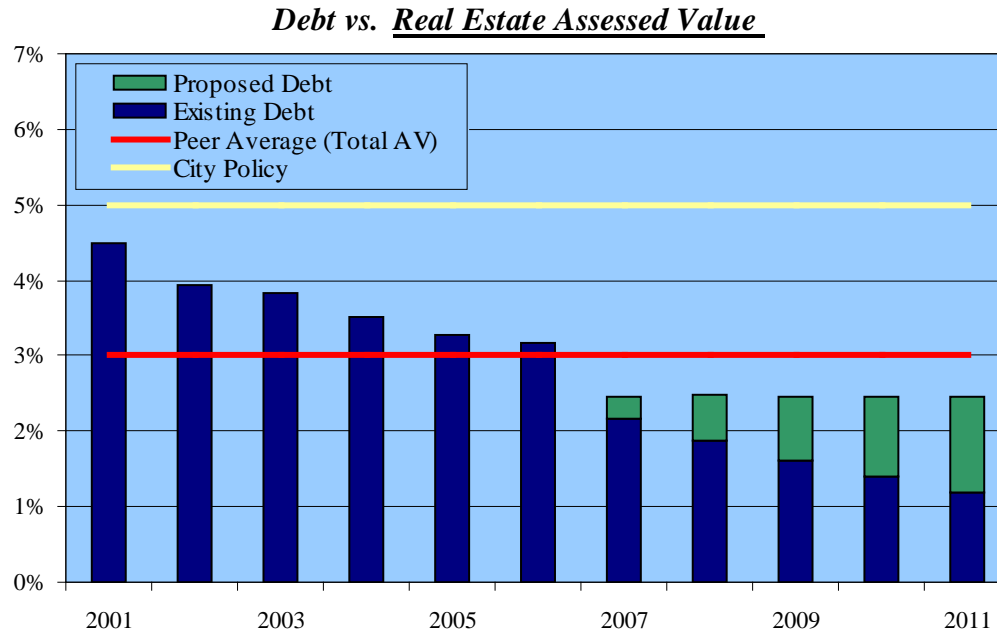
Multi-Year Borrowing Plan

2007:	\$21,950,000
2008:	26,250,000
2009:	26,250,000
2010:	26,500,000
2011:	<u>26,500,000</u>
Total	\$127,450,000

- Future Annual Growth of General Government Expenditures Estimated at 7%.
  - 5 Year Average Historical Growth: 9.32%
- Future Annual Growth of Assessed Value Estimated at 5%.
  - 5 Year Average Historical Growth: 21.02%

# Impact of FY 2007-2011 CIP - Debt-to-Assessed Value

- **City Policy:** Tax-Supported Debt Outstanding Shall Not Exceed 5% of Real Estate Assessed Value.

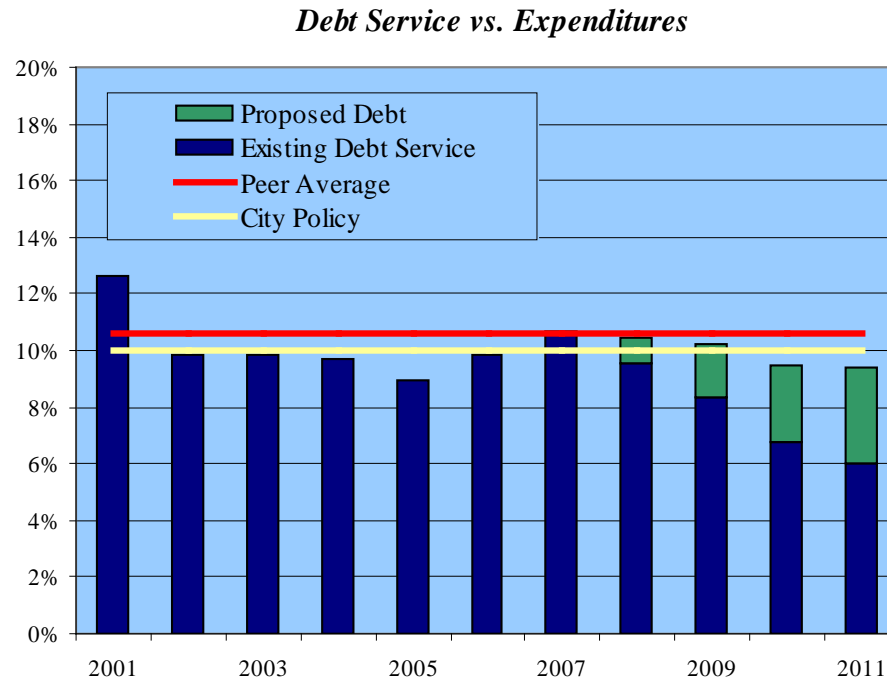


*Note: Peer Average Measured as Debt versus Total Assessed Value as Opposed to Debt versus Real Estate Assessed Value per Calculation Methodology Utilized by the Rating Agencies..*

- City Can Meet All Planned CIP Borrowings Comfortably Under This Policy.

# Impact of FY 2007-2011 CIP - Debt Service vs. General Government Expenditures\*

- **City Policy:** Outstanding Tax-Supported Debt Maintained At or Below 10% of General Government Operating Expenditures.



- City will Need to Reconfigure its Existing Borrowing Plan to Maintain Compliance with this Policy.

## **Pro-Forma Debt Affordability**

# Debt Affordability Analysis - Overview

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- Debt Capacity Defines the Amount of Future Debt Issuance Possible Under the City's Existing Debt Policy Guidelines.
- Irrespective of the Issuance Size, Debt Service Must Be Matched with Cash Flow Sufficiency.
- Debt Affordability Analysis Identifies All Proposed CIP Borrowings and Assesses the Budgetary Cash-Flow Impact of them by Equating it to an Equivalent Tax Rate.

# Debt Affordability Analysis – Key Assumptions

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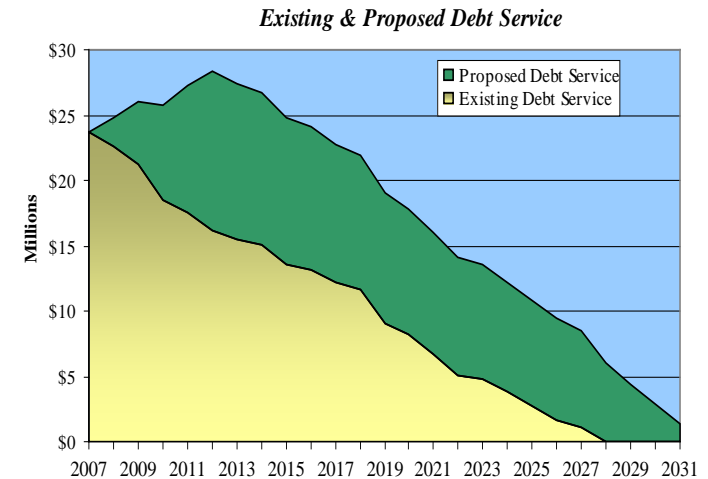
- 1¢ on the Real Estate Tax in Fiscal Year 2007 = \$750,000.
- Current City-Wide Real Estate Tax Rate = \$0.94.
- Historical Five Year Average Annual Growth of 1¢ on the Real Estate Tax Rate = 21.02%.
  - Davenport Conservatively Projected Future Annual Growth of 1¢ on the Real Estate Tax Rate = 5.0%.
  - Estimated Future Growth of Real Assessed Value Takes Into Account Annual Assessment and Current Slowing of Real Estate Market.
- Current General Fund, Tax Supported Debt Outstanding Approximately Equal to \$183 million.
- Cost of Issuance Estimates for Each Borrowing Incorporated Into Analysis.

# Value and Growth of 1¢ On the Real Estate Tax Rate

A	B	C	D	E
<u>Calendar Year</u>	<u>Real Estate Valuation</u>	<u>Growth Rate</u>		
2000	2,989,589,734	N/A		
2001	3,214,916,240	7.54%		
2002	3,550,493,080	10.44%		
2003	4,062,746,844	14.43%		
2004	4,716,665,061	16.10%		
2005	5,785,578,141	22.66%		
2006	7,615,318,300	31.63%		
2007	7,996,084,215	5.00%	Fiscal	<u>Value of 1¢</u>
2008	8,395,888,426	5.00%	<u>Year</u>	2007 750,000
2009	8,815,682,847	5.00%		2008 787,500
2010	9,256,466,989	5.00%		2009 826,875
2011	9,719,290,339	5.00%		2010 868,219
2012	10,205,254,856	5.00%		2011 911,630
2013	10,715,517,599	5.00%		2012 957,211
				2013 1,005,072
				2014 1,055,325
				<i>Assumes</i>
				<i>Annual</i>
				<i>Reassessment</i>
Five Year Average Growth Rate:		21.02%		
Projected Growth Rate:		5.00%		

# Existing and Proposed CIP Debt Service (FY 2007-2011)

Fiscal Year	Existing Debt Service	FY 2007-2011 CIP G.O. Bonds Debt Service Requirements			Total Existing & Proposed
	(P+I)	Principal	Interest	Total	(P+I)
2007	\$23,743,787	\$0	\$0	\$0	\$23,743,787
2008	22,654,072	1,105,000	1,053,313	2,158,313	24,812,385
2009	21,280,114	2,435,000	2,325,575	4,760,575	26,040,689
2010	18,453,647	3,760,000	3,531,350	7,291,350	25,744,997
2011	17,528,933	5,100,000	4,683,375	9,783,375	27,312,308
2012	16,172,538	6,430,000	5,768,400	12,198,400	28,370,938
2013	15,547,034	6,430,000	5,449,663	11,879,663	27,426,697
2014	15,128,146	6,435,000	5,130,938	11,565,938	26,694,084
2015	13,550,662	6,430,000	4,811,963	11,241,963	24,792,624
2016	13,161,294	6,435,000	4,493,225	10,928,225	24,089,519
2017	12,166,214	6,435,000	4,174,250	10,609,250	22,775,464
2018	11,700,421	6,430,000	3,855,275	10,285,275	21,985,696
2019	9,037,606	6,430,000	3,536,550	9,966,550	19,004,156
2020	8,154,525	6,430,000	3,217,813	9,647,813	17,802,338
2021	6,683,939	6,435,000	2,899,088	9,334,088	16,018,026
2022	5,087,024	6,430,000	2,580,113	9,010,113	14,097,137
2023	4,827,705	6,435,000	2,261,375	8,696,375	13,524,080
2024	3,772,485	6,435,000	1,942,400	8,377,400	12,149,885
2025	2,733,830	6,435,000	1,623,425	8,058,425	10,792,255
2026	1,705,338	6,435,000	1,304,450	7,739,450	9,444,788
2027	1,052,738	6,430,000	985,475	7,415,475	8,468,213
2028	0	5,325,000	666,750	5,991,750	5,991,750
2029	0	3,995,000	400,500	4,395,500	4,395,500
2030	0	2,675,000	200,750	2,875,750	2,875,750
2031	0	1,340,000	67,000	1,407,000	1,407,000
<b>Total</b>	<b>\$244,142,053</b>	<b>\$128,655,000</b>	<b>\$66,963,013</b>	<b>\$195,618,013</b>	<b>\$439,760,066</b>



# Estimated Equivalent Tax Rate Impact

## Incremental Tax Increases on an “As Needed” Basis

<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>	<i>E</i>	<i>F</i>	<i>G</i>	<i>H</i>	<i>I</i>
	<b>Annual Net Debt Service Payments</b>			<i>LESS</i>	<i>LESS</i>	<i>LESS</i>	<i>EQUALS</i>	
		Estimated	<b>Total</b>	Maintain	Use of/		Additional	Estimated
		New Debt	<b>Existing</b>	FY2007	(Addition to)		Dollars	Incremental
Fiscal	Existing	Service	<b>&amp; Proposed</b>	Debt Service	Capital	Incremental	(Needed)/	Tax Effect <sup>(1)</sup>
<u>Year</u>	<u>Debt Service</u>	<u>Service</u>	<u>Debt Service</u>	<u>Level</u>	<u>Reserve Fund</u>	<u>Tax</u>	<u>Surplus</u>	
2007	\$23,743,787	\$0	<b>\$23,743,787</b>	\$23,743,787		N/A	N/A	0.00
2008	22,654,072	2,158,313	<b>24,812,385</b>	23,743,787	0	1,575,000	506,402	<b>0.02</b>
2009	21,280,114	4,760,575	<b>26,040,689</b>	23,743,787	0	2,480,625	183,723	<b>0.01</b>
2010	18,453,647	7,291,350	<b>25,744,997</b>	23,743,787	0	2,604,656	603,446	0.00
2011	17,528,933	9,783,375	<b>27,312,308</b>	23,743,787	0	3,646,519	77,998	<b>0.01</b>
2012	16,172,538	12,198,400	<b>28,370,938</b>	23,743,787	0	4,786,056	158,905	<b>0.01</b>
2013	15,547,034	11,879,663	<b>27,426,697</b>	23,743,787	0	5,025,359	1,342,449	0.00
2014	15,128,146	11,565,938	<b>26,694,084</b>	23,743,787	0	5,276,627	2,326,330	0.00
					0		<b>Total Tax Impact =</b>	<b>0.05</b>

Notes:

*Funded via  
Excess Monies  
from Prior Years  
Tax Increase*

Additional dollars  
needed divided by  
value of 1¢ in  
that fiscal year.

*Questions?*

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